Why Delaware Courts Should Abolish The Schnell Doctrine

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ARTICLES

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INTRODUCTION

Today, the proposition that Delaware courts can grant equitable relief is incontrovertible. Apparently, however, this proposition was debatable after the passage in 1967 of the Delaware General Corporation Law ("DGCL").[1]

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1. *See* Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are*

Many scholars credit the *Schnell* doctrine, created in 1971, with securing the current availability of equitable relief.[2] The *Schnell* doctrine permits courts to invalidate conduct that is technically in compliance with applicable law if the court deems that conduct to be inequitable;[3] therefore, compliance with the corporate statute is the minimum, but not necessarily the sole, requirement for legality. Throughout its forty-five-year life, the *Schnell* doctrine has surfaced intermittently in Delaware case law. Recently, the doctrine has moved front and center in Delaware corporate law as Delaware courts have raised the specter of the *Schnell* doctrine to test the validity of contentious director-enacted bylaws if and when corporations implement them.[4] While the *Schnell* doctrine is ingrained in Delaware law, this Article nevertheless offers a bold recommendation: abolish the *Schnell* doctrine entirely. The reason is simple: the *Schnell* doctrine adds nothing positive to existing Delaware law.

The thesis of this Article accepts the view that *Schnell* has served the critical function of establishing the role of equity, but argues that the *Schnell* doctrine is currently superfluous for one reason: there is—or should be—a *Schnell* violation only when there is also a breach of fiduciary duty. Thus, the coexistence of the *Schnell* doctrine and fiduciary breaches incorrectly suggests that a *Schnell* violation is different from a breach of fiduciary duty and imposes costs for this incorrect inference. Since the doctrine imposes costs and offers no discernable current benefit, this Article recommends that Delaware courts abolish the *Schnell* doctrine. Because this Article agrees with the vital role of equity in Delaware corporate law, but contends that the *Schnell* doctrine no longer adds to that

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Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft, 60 BUS. LAW. 877, 881 (2005) (discussing that some members of the Delaware bar in 1967 believed that the newly-passed Delaware General Corporation Law (DGCL) occupied the "entire field of corporate law").

2. *See infra* notes 17–21 and accompanying text (depicting slightly different views of the early role of the *Schnell* doctrine).

3. *See infra* note 16 and accompanying text.

4. Delaware courts have held that forum-selection bylaws, *see* City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 233–34 (Del. Ch. 2014); Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 940 (Del. Ch. 2013), and fee-shifting bylaws in non-stock corporations, *see* ATP Tours, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557–58 (Del. 2014), are facially valid, but they have also held that they would review these bylaws again under the *Schnell* doctrine should the corporations implement these respective bylaws. *See, e.g.*, *ATP Tours*, 91 A.3d at 558. Subsequent Delaware legislation made the former valid, *see* DEL. CODE ANN. tit. 8 § 115 (West 2015), and the latter invalid for stock companies, *see id.* §§ 102(f), 109(b). The Delaware legislature did not invalidate *ATP*'s holding that fee-shifting bylaws are valid in the context of non-stock corporations. *See id.* § 114(b)(2) (stating that Sections 102(f) and 109(b) shall not apply to non-stock corporations); *see also infra* notes 116–123 and accompanying text.

vitality, this proposal would not weaken the robust protection that equity currently provides.

Part I first discusses the *Schnell* case and how, at its origin, it established the role of equity in judicial review. Thereafter, Part I discusses two other key cases: *Weinberger v. UOP, Inc.*[5] and *Blasius Industries, Inc. v. Atlas Corp.*[6] All three cases are identical in one respect: after finding that the respective directors meticulously complied with the relevant statutory provisions, the Delaware courts in these three cases nevertheless held that such compliance alone was insufficient. The most interesting aspect of these cases for the purposes of this Article is that these courts gave three different responses regarding why the directors' conduct was invalid: (1) the Delaware Supreme Court in *Schnell* held that the directors' conduct was inequitable; (2) the Delaware Supreme Court in *Weinberger* held that directors and controlling shareholders violated their fiduciary duty of loyalty; and (3) the Delaware Chancery Court in *Blasius* also held that the directors violated their duty of loyalty, but reasoned that, because the directors had acted in good faith, this violation was unintentional.

Since the court's response in *Schnell* was that the conduct was inequitable, and the response in *Weinberger* and *Blasius* was that the conduct breached the directors' fiduciary duties, Part II begins by examining all cases where Delaware courts found *Schnell* violations and concludes that all but two were nothing more than fiduciary breaches. Part II then posits that these two outlier cases illuminate the cost of retaining the *Schnell* doctrine because the judges in these two cases invalidated legal conduct based solely on their sense that the directors had acted unfairly. Although legislation has resolved the contentious issues raised in two other recent cases,[7] Part II concludes with an analysis of these two cases that Delaware courts had, prior to this legislation, reserved for a future *Schnell* analysis. As a result, while Part I demonstrates that, at its origin, the *Schnell* doctrine served a valuable function, Part II demonstrates that today, the doctrine is superfluous—as any *Schnell* violation should constitute a breach of fiduciary duties— and dangerous if the forbidden conduct falls short of the fiduciary mark.

Part III questions the status quo, which is that Delaware courts currently can utilize both the *Schnell* doctrine and fiduciary law to invalidate otherwise legal conduct. After examining whether there are benefits from

5. 457 A.2d 701 (Del. 1983).

6. 564 A.2d 651 (Del Ch. 1988); *see also* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1127-32 (Del. 2003) (affirming the *Blasius* doctrine).

7. *See ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 555 (Del. 2014); *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013); *see* also *supra* note 4.

using these overlapping tools, the Article rejects all arguments that favor maintaining the *Schnell* doctrine. In addition, Part III concludes that while there are no costs, there are benefits to abolishing the doctrine. Thus, the Article concludes with the recommendation that Delaware courts consider abolishing the *Schnell* doctrine.

I. THE *SCHNELL* DOCTRINE AND ITS ROLE IN DELAWARE LAW

A. Schnell

When the Delaware legislature passed the DGCL in 1967, the debatable issue was not whether directors had to comply with the statute, but whether such compliance alone was sufficient. Now Chief Justice of the Delaware Supreme Court, but then-Vice Chancellor of the Delaware Court of Chancery, Leo Strine, wrote that "some elements of the Delaware bar believed that the then-new DGCL should be viewed as more or less occupying the entire field of corporate law . . . ."[8] This view of the DGCL was tested in *Schnell v. Chris-Craft Industries, Inc.* when incumbent directors of Chris-Craft Industries, fearing they would lose a proxy fight, took two actions that the corporate statute and the corporation's governing documents authorized: the directors accelerated the annual meeting by five weeks, and they moved the meeting location from its usual place in New York City to a remote part of upstate New York.[9] The dissidents sued, claiming that the directors' actions effectively thwarted the dissidents' ability to conduct a proxy contest that they had planned for the original meeting date.[10] In contrast, the directors argued that they had the power to take the two steps that they did—a view the Delaware Court of Chancery shared. The Delaware Court of Chancery reasoned that, since the board's actions complied with the statute, the corporation's certificate, and its bylaws, the court could not order any relief.[11]

The Delaware Supreme Court reversed the lower court's decision.[12] In a three-page opinion, the Delaware Supreme Court reasoned that because corporate management had attempted to use the corporate statute for the purposes of "perpetuating itself in office"[13] and "obstructing the legitimate efforts of dissident stockholders,"[14] corporate management's conduct was

8. *See* Strine, *supra* note 1, at 881.
9. 285 A.2d 430, 431–32 (Del. Ch. 1971), *rev'd,* 285 A.2d 437 (Del. 1971).
10. *Id.* at 432.
11. *Id.* at 437.
12. *See generally* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971).
13. *Id.* at 439.
14. *Id.*

inequitable.[15] The court did not mention the words "fiduciary duties" in describing the directors' conduct. In response to the directors' and the chancery court's view that the directors had the legal authority to take the actions they took, the Delaware Supreme Court created the maxim that has become known as the *Schnell* doctrine: "[I]nequitable action does not become permissible simply because it is legally possible."[16]

Chief Justice Strine has credited the *Schnell* doctrine with changing Delaware law to its current status where directors must comply with both their legal and equitable obligations.[17] Former Delaware Supreme Court Justice Jack Jacobs expressed a slightly different view, arguing that the 1967 DGCL revisions sought to respond to the need of the Delaware bar for predictability but that equity always had some role.[18] Whatever the vibrancy of the role of equity after the DGCL passed, however, all agree that the *Schnell* doctrine ingrained the important role of equity in judicial review.[19] Indeed, another Delaware Supreme Court Justice, Randy Holland, wrote that "*Schnell* made it plain that in Delaware, equity trumps."[20] One article described well the interplay of the Delaware statute and the *Schnell* doctrine:

> [T]he DGCL gives directors a strong hand to manage the corporation, and the primary non-ballot box legal constraint on them is the enforcement of their equitable fiduciary duties. That is, what is critical to recognize is that the powers entrusted to directors by the DGCL may only be exercised to advance proper corporate interests. Modernly, that principle is most famously embodied in the Delaware Supreme Court's decision in *Schnell v. Chris-Craft Industries, Inc.*, which reaffirmed the long-standing notion that 'inequitable action [is] not . . . permissible

15. *Id.*

16. *Id.*

17. *See* Strine, *supra* note 1, at 881 (noting that *Schnell* was the first case to reject "the proposition that compliance with the DGCL was all that was required of directors to satisfy their obligations to the corporation and its stockholders").

18. Jack B. Jacobs, *The Uneasy Truce Between Law And Equity in Modern Business Enterprise Jurisprudence*, 8 DEL. L. REV. 1, 5–6 (2005); *cf.* Robert K. Clagg, Jr., *An "Easily Side-Stepped" And "Largely Hortatory" Gesture?: Examining the 2005 Amendment to Section 271 of the DGCL*, 58 EMORY L.J. 1305, 1320 (2009) ("The role of equity in Delaware's corporate jurisprudence has ebbed and flowed throughout history, always making its exact place somewhat difficult to pin down.").

19. *See* Jacobs, *supra* note 18, at 7 (stating that *Schnell* "marked the birth of the 'equity' model first in Delaware and later in other states"); Strine, *supra* note 1, at 883.

20. DELAWARE SUPREME COURT: GOLDEN ANNIVERSARY 1951-2001 92 (Randy J. Holland & Helen L. Winslow eds., 2001); *see also* Clagg, *supra* note 18, at 1320–21 (noting that *Schnell* "gave rise to the basic equitable dynamic inherent in Delaware's corporate jurisprudence today"); J.W. Verret, *Defending Against Shareholder Proxy Access: Delaware's Future Reviewing Company Defenses in the Era of Dodd-Frank*, 36 J. CORP. L. 391, 418 (2011) (noting that the DGCL gave directors wide discretion that is tempered by the *Schnell* doctrine).

> simply because it is legally possible.' In *Schnell*, the Delaware Supreme Court emphatically voiced its acceptance of the importance of fiduciary duty review in ensuring that the capacious authority granted to directors by the DGCL was not misused.[21]

Thus, if there had been any question of the existence or vitality of the role of equity after the DGCL passed, *Schnell* ended that debate.

B. Weinberger

In *Weinberger v. UOP, Inc.*,[22] the Delaware Supreme Court resolved the contentious issue of the requirements for a controlling-shareholder merger that freezes out minority shareholders. Although the directors complied with the merger requirements of the DGCL,[23] the Delaware Supreme Court in *Weinberger* invalidated the going-private transaction at hand without mentioning the *Schnell* doctrine.[24] Instead, the court reasoned that the directors had breached their fiduciary duties in this conflict-of-interest transaction because the directors denied critical information both to the corporation's outside directors and to the minority shareholders, thus negating any validation of the transaction from the shareholder vote.[25] Moreover, because the shareholder vote was invalid, defendants had to demonstrate that the merger was entirely fair, a burden they failed to meet.[26] Noting that it was a long-held view that majority shareholders and

21. Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporate Law*, 98 GEO. L.J. 629, 641–42 (2010). The interplay of the *Schnell* doctrine and fiduciary review, as conveyed in the quoted text, is central to this Article's thesis and will be discussed in more detail *infra* Part II.

22. 457 A.2d 701 (Del. 1983).

23. DEL. CODE ANN. tit. 8 § 251 (West 2015).

24. While not criticizing *Weinberger* for failing to discuss the *Schnell* doctrine, one article noted that *Weinberger*'s significance is tied to the *Schnell* doctrine, stating that "[i]n fairness, *Schnell* . . . is the real genesis of this change, permitting courts to set aside otherwise lawful transactions if they find unfairness, thus elevating equity over law." William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 18 n.94 (2009).

25. *Weinberger*, 457 A.2d at 712. The Delaware Supreme Court also held: (i) Plaintiffs, in challenging a cash-out merger, shoulder the initial burden of alleging specific acts of fraud, misrepresentation, or other misconduct to demonstrate the unfairness of the merger terms to the minority, *id.* at 703; (ii) Where corporate action has been approved by an informed vote of a majority of the minority shares, plaintiffs bear the burden of showing the transaction was unfair to the minority, *id.*; (iii) Going-private transactions no longer need to have a valid business purpose, *id.* at 705–06; (iv) Entire fairness requires both fair dealing and fair price, *id.* at 711; (v) The valuation methodology in an appraisal proceeding should be based on all relevant valuation criteria rather than the traditional Delaware block method, *id.* at 712–13; and (vi) The remedy of quasi-appraisal rights would be available to certain shareholders so they could utilize *Weinberger's* new valuation methodology, *id.* at 714–15.

26. *Id.* at 703.

the directors they designate owe the target corporation and its minority shareholders an "uncompromising duty of loyalty,"[27] the court wrote: "There is no 'safe harbor' for such divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."[28]

C. Blasius

In *Blasius Industries, Inc. v. Atlas Corp.*, the directors acted in full compliance with both the DGCL and Atlas Corporation's ("Atlas") charter when, in the midst of a proxy contest from Blasius Industries ("Blasius"), the Atlas directors increased the size of the board by two positions and then filled those two board vacancies.[29] While the directors' actions increased the Atlas board from seven to nine members, Atlas' charter permitted a fifteen-member board.[30] The net effect, however, thwarted Blasius' chance to elect a majority of directors, as now there were only six open seats—instead of eight—on the fifteen-member Atlas board. Blasius attacked the Atlas board's action as an entrenchment tactic, in violation of the *Schnell* doctrine.[31] The Delaware Court of Chancery reasoned that if Blasius was correct that the Atlas board was acting for selfish reasons, the board's action would clearly violate the *Schnell* doctrine: "[P]laintiffs say . . . that asserted policy differences were pretexts for entrenchment for selfish reasons. If this were found to be factually true, one would not need to inquire further. The action taken would constitute a breach of duty. *Schnell* . . . ."[32] Chancellor William Allen ultimately concluded, however, that the board was acting in good faith, not selfishly, in order to thwart Blasius' plan which the directors feared would harm the corporation.[33] Despite this finding, the Atlas directors were not off the hook, as the court reasoned that the directors' good faith could not create power for the board that it lacked; instead, the court held that directors lacked the power to act for the sole or primary purpose of thwarting a shareholder vote:[34]

> The only justification that can . . . be offered for the action taken is that

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27. *Id.* at 710.

28. *Id.*

29. 564 A.2d 651, 656 (Del Ch. 1988).

30. *Id.* at 654.

31. *Id.* at 657.

32. *Id.* at 658. *But see infra* notes 92–93 and accompanying text (delineating other cases that have mixed holdings on whether defendants must act with an improper motive to violate the *Schnell* doctrine).

33. *Blasius*, 564 A.2d at 658.

34. *Id.* at 661.

> the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant... when the question is who should comprise the board of directors. The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters .... [T]here is a vast difference between expending corporate funds to inform the electorate and exercising power for the primary purpose of foreclosing effective shareholder action.[35]

The Delaware Court of Chancery formulated a test whereby, if the directors' primary purpose is to disenfranchise their shareholders, the directors must show a compelling purpose for their actions[36]—a burden that the directors in *Blasius* failed to overcome.[37] Moreover, despite finding that the directors had acted in good faith, the court held that the board's action "constituted an unintended violation of the duty of loyalty that the board owed to the shareholders."[38]

To be sure, *Blasius* is a controversial decision from a number of perspectives, largely due to the incongruities of the compelling-purpose test.[39] What has not been under attack, however, is the court's reasoning that directors are not home-free simply because their actions complied with the statute. The most noteworthy point for this Article is the court's

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35. *Id.* at 663.

36. *Id.* at 661; *see also* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003) (affirming the *Blasius* test).

37. *Blasius*, 564 A.2d at 662.

38. *Id.* at 663. The court noted that unintended breaches of the duty of loyalty are "unusual but not novel." *Id.* (citing to Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980), and AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)). For other cases where courts have found that the directors had not acted in their own self-interest but were nevertheless held to have committed a technical violation of the duty of loyalty, see generally *Johnston v. Pedersen*, 28 A.3d 1079 (Del. Ch. 2011), where the directors enacted a provision in a Series B Preferred stock plan to give these shareholders veto power over any change in control to maintain stability in the corporation rather than to entrench themselves in control, and see generally Thorpe v. CERBCO, 676 A.2d 436 (Del. 1995), where the controlling shareholder, as a director, voted against an offer for the corporation to sell all of its assets because he knew he would veto the transaction if the board submitted it to a shareholder vote.

39. One criticism is that the compelling purpose test in not a true test as no directors are ever likely to be able to provide a satisfactory reason for purposefully disenfranchising their shareholders. *See* Mercier v. Inter-Tel, Inc., 929 A.2d 786, 806 (Del. Ch. 2007) (noting that *Blasius*' compelling-justification test is almost impossible to satisfy); Strine, *supra* note 1, at 892 (describing the compelling-justification test as an "admittedly onerous standard"). Another criticism is, despite Chancellor Allen's reasoning to the contrary, that the board did have the power to take the action it took. *See id.* at 891 ("The Atlas board deprived Blasius of no legal right; it merely closed off an opportunity that had dropped in Blasius's lap because of the Atlas board's prior inattention .... [T]he Atlas board was empowered to do just what it did.").

conclusion that because the directors were not acting selfishly, they could violate their fiduciary duty of loyalty unintentionally but could not violate the *Schnell* doctrine.[40] In so holding, Chancellor Allen articulated a view that the *Schnell* doctrine invalidates only selfish conduct.[41] Moreover, Chancellor Allen delineated the capacious breadth of the duty of loyalty as encompassing both selfish as well as good-faith violations.[42]

D. Summary of Schnell, Weinberger, *and* Blasius

While *Schnell* established equitable review in Delaware corporate law, *Weinberger* and *Blasius* added to that dynamic. Both *Schnell* and *Blasius* pertained to directors' attempts to interfere with shareholder voting, while *Weinberger* concerned a going-private transaction. Both *Schnell* and *Weinberger* held that directors acted out of self-interest, while the court in *Blasius*, in contrast, found that the directors were not acting selfishly.[43] The court in *Blasius* nevertheless held that the directors breached their duty of loyalty, as did the court in *Weinberger*. Finally, while *Schnell* does not mention fiduciary duties and *Weinberger* does not mention the *Schnell* doctrine, *Blasius* discusses both the *Schnell* doctrine and fiduciary duties.

The import of considering *Weinberger* and *Blasius* together is to highlight that there can be both inequitable as well as good-faith breaches of the duty of loyalty. While it is clear that *Schnell*'s inequitable conduct is different from *Blasius*' good faith breach of fiduciary duties and there are different judicial views on whether a bad motive is required to violate the *Schnell* doctrine,[44] the pivotal remaining issue is whether *Schnell*'s inequitable conduct is different from *Weinberger*'s inequitable breach of fiduciary duty. The next section will demonstrate that a true *Schnell* violation is nothing more than a breach of fiduciary duty.

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40. *See supra* notes 33, 38, and accompanying text.

41. Some subsequent cases disagree that *Schnell* violations require an improper motive. *See infra* notes 92–93 and accompanying text (delineating cases that hold improper motive is not required to violate the *Schnell* doctrine from cases that hold the opposite).

42. Delaware courts have enlarged the contours of the duty of loyalty not only by including both intentional and unintentional violations, *supra* note 38 and accompanying text, but also by including issues outside of the traditional financial self-dealing, such as breaches of the duty of good faith. *See* Stone v. Ritter, 911 A.2d 362, 370 ("Good faith is a subsidiary element . . . of the fundamental duty of loyalty.") (internal quotations omitted).

43. *See supra* notes 13, 25, 33, and accompanying text.

44. *See infra* notes 92–93 and accompanying text (discussing the conflict among cases regarding whether an improper motive is needed to violate the *Schnell* doctrine).

II. IS *SCHNELL*'S INEQUITABLE CONDUCT DIFFERENT FROM A BREACH OF FIDUCIARY DUTY?

As noted above,[45] the Delaware Supreme Court in *Schnell* invalidated the directors' action on equitable grounds, but it never addressed whether the directors had breached their fiduciary duties. The issue of whether *Schnell's* failure to label the directors' inequitable conduct a breach of fiduciary duty meant that Delaware courts view these as different doctrines has mixed support in the *Schnell* cases: some *Schnell* cases fail to mention fiduciary duties;[46] some *Schnell* cases discuss fiduciary duties without concluding that the directors breached them;[47] and other cases invoke the *Schnell* doctrine to warn fiduciaries of the courts' equitable powers[48] but instead base the holding on a violation of fiduciary duty.[49]

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45. *Supra* notes 13–16 and accompanying text.

46. *See* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (holding that management's conduct was inequitable without mentioning "fiduciary duties" in describing the directors' conduct); Lerman v. Diagnostic Data, Inc., 421 A.2d 906, 914 (Del. Ch. 1980) (holding that the board's bylaw amendment was inequitable under *Schnell* without mentioning fiduciary duties); Telvest, Inc. v. Olson, 1979 WL 1759, at *7 (Del. Ch. Mar. 8, 1979) (finding that the board's distribution of preferred stock was the kind of conduct "deplored in *Schnell*" without mentioning fiduciary duties even though the board's decision was self-serving and improperly motivated).

47. *See* Esopus Creek Value LP v. Hauf, 913 A.2d 593, 602–05 (Del. Ch. 2006) (discussing fiduciary duties, but finding that the directors' decision, although made without improper motive or entrenchment effect, was unfair under *Schnell*); Linton v. Everett, No. 15219, 1997 WL 441189, at *10 (Del. Ch. July 31, 1997) (finding that the directors' bylaw amendment was inequitable under *Schnell* without discussing fiduciary duties in this part of the opinion); Packer v. Yampol, 1986 WL 4748, at *13-18 (Del. Ch. Apr. 18, 1986) (discussing the board's fiduciary duties but finding that the creation of preferred voting stock was a violation of *Schnell* without concluding that the board violated its fiduciary duties); Dart v. Kohlberg, Kravis, Roberts & Co., No. 7366, 1985 WL 21145, at *5 (Del. Ch. May 9, 1985) (dismissing the plaintiffs' allegations that they could state a claim for breach of fiduciary duty but finding that it was possible that a leveraged buy-out could have "resulted in an impermissible inequity" to the shareholders under *Schnell*).

48. *See, e.g.*, Delaware Ins. Guar. Ass'n v. Christiana Care Health Servs., Inc., 892 A.2d 1073, 1078 (Del. 2006) (citing, but not applying, *Schnell* to the issue of whether a successor corporation in a merger became the insured party under an insurance policy); Farahpour v. DXK, Inc., 635 A.2d 894, 901 (Del. 1994) (citing *Schnell* and suggesting that courts could invalidate a corporation's conversion from a nonprofit, non-stock corporation to a for-profit stock corporation, but ultimately declining to do so); Giuricich v. Emtrol Corp., 449 A.2d 232, 239 (Del. 1982) (citing *Schnell* to warn fiduciaries that "careful judicial scrutiny will be given a situation in which the right to vote for the election of successor directors has been effectively frustrated and denied by the willful perpetuation of a shareholder-deadlock and the resulting entrenched board of directors" but not basing the holding on the *Schnell* doctrine); Petty v. Penntech Papers, Inc., 347 A.2d 140, 143 (Del. Ch. 1975) (citing to *Schnell* but declining to use the doctrine to invalidate directors' attempt to redeem preferred shares).

49. *See, e.g.*, MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1132 (Del. 2003) (citing *Schnell* but basing the holding on other cases and concluding that the directors

Complicating this analysis is that there are only a handful of *Schnell* cases, and, as yet, courts have not established any unifying set of rules to cabin this doctrine.[50] Specifically, courts in only fourteen cases, including *Schnell* itself, have invalidated conduct based on the *Schnell* doctrine.[51] In two of these fourteen *Schnell* cases, the courts found both a *Schnell* violation and a breach of the duty of loyalty;[52] in five other cases, the

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breached their fiduciary duties); Phillips v. Insituform, Inc., No. 9173, 1987 WL 16285, at *9–10 (Del. Ch. Aug. 27, 1987) (citing *Schnell* but basing the holding on another doctrine and concluding directors breached their fiduciary duties); Am. Pac. Corp. v. Super Food Servs., Inc., No. 7020, 1982 WL 8767, at *325 (Del. Ch. Dec. 6, 1982) (citing *Schnell* but granting injunctive relief based on Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) and finding that the directors breached their fiduciary duties); Young v. Valhi, 382 A.2d 1372, 1378 (Del. Ch. 1978) (citing *Schnell* but holding that the directors breached their fiduciary duty).

50. Of the fourteen cases discussed, *infra* note 51, six are about shareholder voting for directors. *See Schnell*, 285 A.2d at 437; Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 45 (Del. Ch. 2008); *Linton*, 1997 WL 441189, at*1; Hubbard v. Hollywood Park Realty Enters., Inc., No. 11779, 1991 WL 3151, at *1 (Del. Ch. Jan. 14, 1991); *Packer*, 1986 WL 4748, at *1; *Lerman*, 421 A.2d at 912. The remaining eight cases are about mergers or are transactional law related. *See* Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1100 (Del. 1985); Singer v. Magnavox Co., 380 A.2d 969, 971 (Del. 1977), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Berger v. Intelident Solutions, Inc., 911 A.2d 1164, 1166 (Del. Ch. 2006); *Esopus*, 913 A.2d at 598–601; Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1028–30 (Del. Ch. 2004); Hamilton v. Nozko, No. 13014, 1994 WL 413299, at *1 (Del. Ch. July 27, 1994); *Dart*, 1985 WL 21145, at *1; *Telvest*, 1979 WL 1759, at *1. Four of these cases involved shareholder voting on transactions. *See Esopus*, 913 A.2d at 598–601; *Berger*, 911 A.2d at 1166; *Dart*, 1985 WL 21145, at *1; *Telvest*, 1979 WL 1759, at *1. *See generally* Mary Siegel, *Going Private: Three Doctrines Gone Astray*, 4 N.Y.U. J.L. & BUS. 399, 420–21 (advocating that, while the *Schnell* doctrine facially has no subject-matter limits, courts should limit the doctrine to cases that negatively impact shareholders' voting rights).

51. *Rabkin*, 498 A.2d at 1107; *Singer*, 380 A.2d at 979–80; *Schnell*, 285 A.2d at 437; *Portnoy*, 940 A.2d 43, at 74–75; *Esopus*, 913 A.2d at 604–05; *Berger*, 911 A.2d at 1174–75 ; *Hollinger*, 844 A.2d at 1081; *Linton*, 1997 WL 441189, at *9–10; *Hamilton*, 1994 WL 413299, at *6–7; *Hubbard*, 1991 WL 3151, at *7, *12 n.9; *Packer*, 1986 WL 4748, at *15; *Dart*, 1985 WL 21145, at *5; *Lerman*, 421 A.2d 913; *Telvest*, 1979 WL 1759, at *1–2. Courts in a few other cases have considered applying the *Schnell* doctrine but found the defendants' strategic maneuvers were not inequitable under *Schnell* because the election process ultimately allowed shareholders to vote. *See* Accipiter Life Sci. Fund, L.P. v. Helfer, 905 A.2d 115, 126–27 (Del. Ch. 2006); Dolgoff v. Projectavision, Inc., Civ.A. No. 14805, 1996 WL 91945, at *7–8 (Feb. 29, 1996); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1123 (Del. Ch. 1990). One court applied the *Schnell* doctrine in the partnership context. *See* Twin Bridges Ltd. P'ship v. Draper, No. Civ.A. 2351-VCP, 2007 WL 2744609, at *21 (Del. Ch. Sept. 14, 2007).

52. *See Portnoy*, 940 A.2d at 74–75 (finding the CEO breached fiduciary duties and violated the *Schnell* doctrine by intentionally using corporate assets to coerce shareholders into voting as the CEO wanted); *Hollinger*, 844 A.2d at 1081 (finding that the conduct of the CEO and controlling shareholder was a breach of fiduciary duty and a violation of *Schnell* because the shareholder-enacted bylaws' sole purpose was to prevent the board from performing its statutorily-authorized duties and to effectuate illegal or inequitable activities).

courts stated, in rejecting a motion to dismiss[53] or in granting a preliminary injunction,[54] that they could find a fiduciary breach and a *Schnell* violation based on the complaint. Thus, in seven of the fourteen cases, the court both applied the *Schnell* doctrine and held, or strongly intimated, that there was a breach of fiduciary duties.

There are two approaches to analyzing the remaining seven cases. In these cases, the respective judges held that there were *Schnell* violations, but the judges either did not mention fiduciary duties or mentioned fiduciary duties only in passing without analyzing or applying them.[55] On the one hand, one can view these cases as involving breaches of fiduciary duty even though the respective judges did not articulate this breach either directly or indirectly. On the other hand, if the prohibited conduct in these cases did not constitute a breach of fiduciary duty, such a holding would suggest that fiduciary conduct can violate the *Schnell* doctrine simply by failing to pass a judge's "smell" test. A review of these seven cases easily puts five in the former category.[56] The directors' conduct in the remaining two cases, *Esopus Creek Value LP v. Hauf*[57] and *Dart v. Kohlberg, Kravis, Roberts & Co.*,[58] however, did not constitute a breach of fiduciary duty. As such, these cases are significant for both exposing a weakness in the *Schnell* doctrine and providing support for abolishing the doctrine.

53. *See Rabkin*, 498 A.2d. at 1106 (reversing the chancery court's dismissal of the plaintiffs' allegation of a "breach of fiduciary duty under *Schnell*. . . ."); *Singer*, 380 A.2d at 980 (reversing the chancery court's dismissal and concluding under *Schnell* that the controlling shareholders manipulated their "corporate power solely to eliminate the minority" in violation of the "fiduciary duty owed by the majority to the minority stockholders"); *Berger*, 911 A.2d at 1174–75 (denying defendants' motion to dismiss under *Schnell* because the defendants intentionally deprived the shareholders of their statutory right to seek appraisal and because the controlling shareholder violated its "fiduciary duty of disclosure"); *Hamilton*, 1994 WL 413299, at *6–7 (denying defendants' motion to dismiss under *Schnell* because the board intentionally delisted the corporation to force the minority to sell their shares at a grossly unfair price, which constituted "an actionable breach of fiduciary duty").

54. *See Hubbard*, 1991 WL 3151, at *7, *12 n.9 (granting a preliminary injunction and finding that the plaintiff was likely to succeed on his claim that directors' failure to waive advance notice bylaws, when the board materially changed its position after the nomination date passed, could constitute a breach of fiduciary duties and a violation of *Schnell*).

55. *See generally Schnell*, 285 A.2d 437; *Esopus*, 913 A.2d 593; *Linton*, 1997 WL 441189; *Packer*, 1986 WL 4748; *Dart*, 1985 WL 21145; *Lerman*, 421 A.2d 906; *Telvest*, 1979 WL 1759.

56. *Schnell*, 285 A.2d 437; *Linton*, 1997 WL 441189; *Packer*, 1986 WL 4748; *Lerman*, 421 A.2d 906; *Telvest*, 1979 WL 1759.

57. 913 A.2d 593 (Del. Ch. 2006); *see* discussion of *Esopus infra* notes 79–85, 90–94, and accompanying text.

58. 1985 WL 21145 (Del. Ch. May 9, 1985); *see* discussion of *Dart infra* notes 86–89, 95–96 and accompanying text.

The first of these seven cases is *Schnell*, where the court reasoned that because corporate management had attempted to use the corporate statute for the purposes of "perpetuating itself in office"[59] and "obstructing the legitimate efforts of dissident stockholders,"[60] management's conduct was inequitable. Similarly, in *Linton v. Everett*, the court found the directors' actions of manipulating the timing of the shareholder meeting—so as to give shareholders short notice of the meeting—deprived the shareholders of a chance to run an opposition slate.[61] Despite the courts' failure in both cases to label the directors' conduct a breach of fiduciary duty, many cases specifically hold that directors or controlling shareholders violate their fiduciary duties if they manipulate the corporate machinery to perpetuate their own control.[62] Indeed, as noted above in *Blasius*,[63] even if directors manipulate the corporate machinery to perpetuate control for unselfish reasons, such manipulations nevertheless constitute a breach of fiduciary duty. As such, the directors in *Schnell* and *Linton* violated their fiduciary duties.

Similarly, if the facts in *Schnell* constitute a breach of fiduciary duty, it is beyond debate that the conduct in the third of these seven cases, *Lerman v. Diagnostic Data, Inc.*,[64] is a breach of fiduciary duty as well. In *Lerman*, the directors of Diagnostic Data, Inc. ("Diagnostic") amended a bylaw so that directors could change the date of the annual meeting from a fixed date to a date to be determined by management. Diagnostic's management then

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59. *Schnell*, 285 A.2d at 439.

60. *Id.*

61. *Linton*, 1997 WL 441189, at *9–10.

62. *See, e.g.*, Singer v. Magnavox Co., 380 A.2d 969, 979–80 (Del. 1977) ("[T]hose who control the corporate machinery owe a fiduciary duty to the minority in the exercise thereof over corporate powers and property, and the use of such power to perpetuate control is a violation of that duty."), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 185 (Del. Ch. 2005) ("Corporate fiduciaries may not utilize corporate machinery for the purpose of perpetuating themselves in office."); Hamilton v. Nozko, No. 13014, 1994 WL 413299, at *6 (Del. Ch. July 27, 1994) (ruling affirmatively and applying the *Schnell* doctrine when answering the question of whether "corporate fiduciaries commit an actionable breach of fiduciary duty" in manipulating the corporate machinery for personal advantage); Chrysogelos v. London, Civ. A. No. 11910, 1992 WL 58516, at *6 (Del. Ch. Mar. 25, 1992) ("[I]f corporate directors manipulate the corporate machinery . . . for the sole or primary purpose of perpetuating themselves in office, they violate a fiduciary duty owed to the corporation and its shareholders.") (internal quotations omitted) (citing Pogostin v. Rice, 480 A.2d 619, 627 (1984)); Societe Holding Ray D'Albion S.A. v. Saunders Leasing Sys., Inc., C.A. No. 6648, 1981 WL 15094, at *1 (Del. Ch. Dec. 16, 1981) (citing *Singer*, 380 A.2d at 979).

63. *See supra* note 38 and accompanying text.

64. 421 A.2d 906, 907, 914 (Del. Ch. 1980).

fixed the date sixty-three days in the future.[65] Since another bylaw required insurgents to submit the names of their nominees more than seventy days before the meeting, the newly-adopted bylaw that changed the meeting date to sixty-three days made it impossible for the insurgents to run a competing slate of nominees.[66] Given that the Schnell board's actions had the effect of hindering insurgents' efforts and that the Lerman board's actions went a step further and actually prevented the insurgents' efforts, the conduct giving rise to the *Schnell* violation in *Lerman* also constituted a breach of fiduciary duty.

While *Schnell* and *Lerman* involved directors manipulating election-related bylaws, Delaware courts have held that other mechanisms that entrench directors in office will also violate the *Schnell* doctrine. Defendant directors in the fourth case, *Packer v. Yampol*, sought to perpetuate themselves in office by issuing newly created preferred stock with supervoting features to the CEO and other defendants.[67] Citing *Schnell,* the Delaware Court of Chancery held that the directors' "primary purpose was to obstruct the plaintiffs' ability to wage a meaningful proxy contest in order to maintain themselves in control."[68] Once again, any manipulation of the corporate machinery to perpetuate control is a violation of fiduciary duties.[69]

Two other cases held directors violated the *Schnell* doctrine for manipulation of shareholder voting, not for the election of directors but for the statutorily-required shareholder vote for organic changes.[70] In the fifth case, *Telvest, Inc. v. Olson*, the board created and sought to dividend preferred stock that required a supermajority vote for organic changes with any shareholder owning twenty percent or more of the common stock.[71]

65. *Id.* at 911.

66. *Id.* at 912.

67. 1986 WL 4748, at *3 (Del. Ch. 1986).

68. *Id.* at *14–15. Although finding that the business judgment rule did not apply because defendants were not disinterested or independent, the court did not analyze whether defendants breached their fiduciary duties and instead held that they violated the *Schnell* doctrine. *See supra* note 47 and accompanying text (delineating a series of *Schnell* cases that discuss fiduciary duties but do not explicitly hold that the directors or controlling shareholders breached such duties).

69. *See supra* note 62 and accompanying text (delineating cases that hold that, if directors or controlling shareholders manipulate the corporate machinery to perpetuate their own control, they have violated their fiduciary duties).

70. The Delaware corporate statute requires a shareholder vote for mergers and consolidations, *see* DEL. CODE ANN. tit. 8 § 251 (West 2015), sales of substantially all assets not sold in the ordinary course of business, *see id.* § 271, and voluntary dissolution, *see id.* § 275. The Delaware default rule requires a majority of outstanding shares to approve these transactions. *See id.* §§ 251(c), 271(a), 275(b).

71. 1979 WL 1759, at *1, *6 (Del. Ch. Mar. 8, 1979).

This newly created preferred stock effectively altered the voting process for the common stock: instead of a majority vote for organic changes, a supermajority would now be required, thereby diluting any challenge to management's incumbency.[72] Plaintiff, the owner of twenty percent of the stock, sought a preliminary injunction against the issuance of this preferred stock and alleged that the board's action was self-serving and improperly motivated.[73] The Delaware Court of Chancery doubted that the new stock was valid preferred stock[74] and, further, doubted that the board could effectively amend the certificate of incorporation's voting requirements simply by a board resolution.[75] Nevertheless, the court assumed, *arguendo*, that the board could legally take the actions proposed.[76] The court nevertheless granted the preliminary injunction, reasoning that the board's conduct "would fall within the type of conduct deplored in *Schnell*."[77] Similar to many other cases that violated the *Schnell* doctrine, the directors' actions that served to entrench them in office constituted a breach of fiduciary duty.[78]

The sixth case, *Esopus Creek Value LP v. Hauf*,[79] is similar to *Telvest* in that the directors in *Esopus* manipulated the voting requirements for organic changes, but it was different in that the *Esopus* directors did not seek to entrench themselves in office. The board in *Esopus* sought to avoid the need for a shareholder vote on a sale of all of the corporation's assets by voluntarily putting the corporation in bankruptcy where no such vote was required.[80] The shareholders sought a preliminary injunction to enjoin the corporation from executing an agreement for the sale of the corporation's assets without a shareholder vote.[81] The Delaware Court of Chancery found that the directors acted in good faith[82] and without an

72. *Id.*

73. *Id.* at *2.

74. *See id.* at *5 (questioning whether the First Series Preferred was really preferred stock because "any supposed preference as to dividends or liquidation rights seems illusory at best").

75. *See id.* at *6 (finding the board's resolution could not "have the effect of amending or supplementing in some respect [the] corporation's original certificate of incorporation") (citing DEL. CODE ANN. tit. 8 § 104).

76. *Id.* at *7.

77. *Id.*

78. *See supra* note 62 and accompanying text (delineating cases that hold that, if directors or controlling shareholders manipulate the corporate machinery to perpetuate their own control, they have violated their fiduciary duties).

79. 913 A.2d 593 (Del. Ch. 2006).

80. *Id.* at 596.

81. *Id.* at 601.

82. *Id.* at 602–03.

entrenchment motive;[83] in fact, the directors' actions would unseat, rather than entrench, them in office.[84] The court nevertheless granted the injunction, reasoning that since the corporation was financially healthy and had admitted that it was using the bankruptcy route to avoid the required shareholder vote: the proposed scheme "work[ed] a profound inequity upon the company's common stockholders and is thus prohibited by the teaching of *Schnell*."[85]

Finally, *Dart v. Kohlberg, Kravis, Roberts & Co.*[86] was not a voting case at all but was instead a suit by a preferred stockholder complaining about various aspects of the defendants' leveraged buy-out ("LBO"). In a motion to dismiss, the court dismissed all of plaintiff's allegations that could possibly state a claim for breach of fiduciary duty; [87] the one allegation that remained attacked the effect of the LBO on the security of the preferred stockholders' investment.[88] Citing *Schnell*, the court explained that

> [a]lthough everything done by defendants may have been in strict compliance with the letter of Delaware law, it is possible that the totality of actions resulted in an impermissible inequity to the holders of the preferred stock. The difficulty with the challenged transaction is that it was highly leveraged and the majority of the preferred stockholders ended up still owning their shares . . . . The assets of the corporation were used as sole security for the loans obtained for the purpose of buying out the common stock and the public preferred stockholders were left holding their shares in a corporation which, as a result of the transaction, has a much greater debt and therefore perhaps a lessened ability to pay preferred dividends. Such a leveraged buy-out calls for judicial scrutiny to prevent possible abuse.[89]

The courts' invocation of the *Schnell* doctrine in these last two cases, *Esopus* and *Dart*, is troubling. The court's holding in *Esopus* is based on the view that the directors' decision to sell the corporation's assets in bankruptcy was inequitable. The holding is troubling, however, because the judge found that the directors were acting in good faith and that their

83. *Id.* at 603.

84. *See id.* (reasoning "a result of the proposed transaction is that Metromedia's board will cease to exist following the plan of reorganization").

85. *Id.* at 604.

86. No. 7366, 1985 WL 21145 (Del. Ch. May 9, 1985).

87. *See id.* at *6 (dismissing fiduciary duty claim based on defendants paying an unfair price); *id.* at *7 (dismissing fiduciary duty claim for disclosure violations in the proxy materials); *cf. id.* at *6 (dismissing claims regarding defendant management getting an ownership interest in the new venture because such claims are derivative in nature and thus could not be brought in its current form as a class action).

88. *See id.* at *5.

89. *Id.*

conduct did not entrench them in office;[90] in contrast, all other *Schnell* violations, except *Dart*,[91] were cases where the directors breached their fiduciary duties.[92] Quite remarkably, in *Esopus*, the challenged conduct

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90. *Supra* notes 82–84 and accompanying text.

91. *See supra* note 87 (noting that the court in *Dart* dismissed all fiduciary duty claims).

92. As *supra* note 50 explains, the *Schnell* cases can be broken down into two categories: those pertaining to voting for directors and those pertaining to transactional issues. Out of the six voting cases, *see supra* note 50, the courts found that the directors were acting with improper motive in three of them. *See* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439–40 (Del. 1971) (granting a preliminary injunction because the board manipulated corporate machinery for the purpose of perpetrating itself in office); Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 74 (Del. Ch. 2008) (setting aside election results because the directors used their power for the purpose of entrenching themselves in office); Packer v. Yampol, 1986 WL 4748, at *15 (Del. Ch. Apr. 18, 1986) (granting a preliminary injunction because the directors' "primary purpose was to obstruct plaintiffs' ability to wage a meaningful proxy contest in order to maintain themselves in control"). The remaining three voting cases invalidated board action when defendants engaged in entrenchment action despite the lack of bad of faith or subjective intent. *See* Linton v. Everett, No. 15219, 1997 WL 441189, at *9 (Del. Ch. July 31, 1997) (setting aside director bylaw amendment because the "conduct of management . . . was both inequitable (in the sense of being unnecessary under the circumstances) and [. . .] had the accompanying dual effect of thwarting shareholder opposition and perpetuating management in office" and stating that "it is not required that . . . actual subjective intent to impede the voting process[] be shown"); Hubbard v. Hollywood Park Realty Enters., Inc., No. 11779, 1991 WL 3151, at *7, *12 n.9 (Del. Ch. Jan. 14, 1991) (granting a preliminary injunction because the "board action constitut[ed] an inequitable manipulation of the corporate machinery that affected adversely the shareholders' right to conduct a contested election of directors" even though the directors "acted in good faith and took no steps overtly to change the electoral rules themselves" and stating that "to be inequitable, such conduct does not necessarily require a dishonest, selfish, or evil motive"); Lerman v. Diagnostic Data, Inc., 421 A.2d 906, 912 (Del. Ch. 1980) (invalidating directors' bylaw amendment because, "whether designedly inequitable or not, [the amendment] has had a terminal effect on the [shareholders' ability to wage a proxy contest]"). In six of the eight transaction cases, *see supra* note 50, the court found that directors or controlling shareholders were improperly motivated and self-interested. *See* Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1106–07 (Del. 1985) (reversing the Delaware Court of Chancery's dismissal because the directors, in bad faith, took inequitable action to avoid its contractual commitment to cash-out the minority shareholders at a fixed price); Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (reversing the Delaware Court of Chancery's dismissal because the merger was made for the sole purpose of freezing out minority shareholders); Berger v. Intelident Solutions, Inc., 911 A.2d 1164, 1174–75 (Del. Ch. 2006) (denying defendants' motion to dismiss because the controlling stockholder, who stood to benefit from not having to pay fair market value, purposefully manipulated the timing of the proxy process in a cash-out merger to intentionally deprive the minority shareholders from seeking their statutory right to appraisal); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1081 (Del. Ch. 2004) (granting a preliminary injunction because "the plain purpose of these [b]ylaw [a]mendments was to disable the [i]nternational board" to keep the controlling shareholder in control); Hamilton v. Nozko, No. 13014, 1994 WL 413299, at *6 (Del. Ch. July 27, 1994) (denying the defendants' motion to dismiss because the defendants

would cause the directors to lose their power, rather than entrench them in it.[93] Thus, there was no finding that the directors were not disinterested or independent or that their decision-making process was faulty. Instead, Vice Chancellor Stephen Lamb's conclusion in *Esopus* that the board's decision was inequitable was based solely on his gut feeling that the directors' decision was unfair. Similarly, in *Dart*, the court dismissed all of the plaintiffs' allegations that could state a claim for breach of fiduciary duty.[94] Despite considering and rejecting all possible fiduciary claims, Vice Chancellor Maurice Hartnett nevertheless held that there could be a *Schnell* violation simply because he perceived the effect of the LBO might increase the risk of the preferred stockholders' investment.[95] Concluding that *Esopus* and *Dart* might be wrongly decided, however, would miss the more important point: *Esopus* and *Dart* expose a critical weakness in the *Schnell* case law.

The weakness in the *Schnell* cases is that, in deciding to invalidate directors' decisions, courts sometimes bypassed the most well-established judicial methodology of reviewing directors' decisions: the business judgment rule. The business judgment rule is designed to preclude judges from second-guessing directors' business decisions by limiting initial judicial review solely to the process by which directors made their decision.[96] In this process, directors enjoy a presumption of propriety.[97] As such, plaintiffs must dislodge this presumption by making a prima facie case that the directors were either not disinterested, not independent, acting

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"committed the Company [to going private] for self-interested purposes, unrelated to any disinterested business judgment as to what was in the corporation's best interests"); Telvest, Inc. v. Olson, 1979 WL 1759, at *1–2 (Del. Ch. Mar. 8, 1979) (granting a preliminary injunction because the directors' distribution of preferred stock, which was done for the sole purpose of preventing a twenty-percent stockholder from securing a merger, was self-serving and improperly motivated); *see also supra* note 32 and accompanying text (noting that the court in *Blasius* assumed that all *Schnell* violations required improper motive).

93. *See supra* note 84 and accompanying text; *cf. Dart*, 1985 WL 21145, at *1 (supporting proposed leveraged buy-out where directors would get an equity position in the refinanced corporation but would lose control of it).

94. *See supra* note 87 and accompanying text.

95. *Dart*, 1985 WL 21145, at *5.

96. *See* STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE 45 (6th ed. 2009) ("[C]ourts give deference to directors' decisions reached by a proper process, and do not apply an objective reasonableness test in such case to examine the wisdom of the decision itself.") (internal citation omitted).

97. *See id.* at 42 (noting that Delaware law "presumes that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interest of the company") (internal quotations omitted); *see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (noting that, under the business judgment rule, courts will not disturb the judgment of directors absent abuse of their decision-making power).

in bad faith, or grossly negligent.[98] If plaintiffs are successful, then—and only then—can the court review the directors' decision. Even then, directors can attempt to show that they nevertheless produced a fair result for the corporation.[99]

In contrast, when judges engaged in a *Schnell* review, they typically did not acknowledge the business judgment rule.[100] Instead, upon receiving the plaintiffs' *Schnell* claims, some courts either did not review the directors' decision-making process, or they did such a review and found the process without fault; nevertheless, some judges concluded that the defendants violated the *Schnell* doctrine.[101] While some *Schnell* cases engaged in this

98. *See* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporate Law*, 56 BUS. LAW. 1287, 1298 (2001) ("[A] standard formulation of the business judgment rule in Delaware is that it creates a presumption that (i) a decision was made by directors who (ii) were disinterested and independent, (iii) acted in subjective good faith, and (iv) employed a reasonable decision making process.").

99. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (holding that, if the business judgment rule is rebutted, the burden shifts to defendant directors to prove the transaction was entirely fair to the shareholders).

100. Seven *Schnell* cases did not mention the business judgment rule. *See* Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971); Berger v. Intelident Solutions, Inc., 911 A.2d 1164 (Del. Ch. 2006); Hubbard v. Hollywood Park Realty Enters., Inc., No. 11779, 1991 WL 3151 (Del. Ch. Jan. 14, 1991); Dart v. Kohlberg, Kravis, Roberts & Co., No. 7366, 1985 WL 21145 (Del. Ch. May 9, 1985); Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980). Three *Schnell* cases mentioned the business judgment rule but not in connection with the *Schnell* analysis. *See* Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 69 (Del. Ch. 2008); Linton v. Everett, No. 15219, 1997 WL 441189, at *7 (Del. Ch. July 31, 1997); Telvest, Inc. v. Olson, 1979 WL 1759, at *6–7 (Del. Ch. Mar. 8, 1979). Only three *Schnell* cases provided an explanation regarding why the business judgment rule was inapplicable. *See* Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1060–61, 1078 (Del. Ch. 2004) (reasoning that the business judgment rule did not apply because the defendant breached his fiduciary duties); Hamilton v. Nozko, No. 13014, 1994 WL 413299, at *6 (Del. Ch. July 27, 1994) (holding the business judgment rule did not apply to these directors because they were neither disinterested nor independent); Packer v. Yampol, 1986 WL 4748, at *14 (Del. Ch. Apr. 18, 1986) (rejecting the defendants' argument that the directors were disinterested and, therefore, protected by the business judgment rule because the directors "stood to benefit" from the "increased likelihood of the directors' continued incumbency").

101. *See* Esopus Creek Value LP v. Hauf, 913 A.2d 593, 602–03 (Del. Ch. 2006) (examining the directors' decision-making process and finding no fault with it but nonetheless evaluating the decision); Dart v. Kohlberg, Kravis, Roberts & Co., No. 7366, 1985 WL 21145, at *5 (Del. Ch. May 9, 1985) (failing to mention the business judgment rule and dismissing all of plaintiffs' allegations that could state a claim for breach of fiduciary duty but nonetheless examining the possible negative impact of the directors' decision); *see also infra* notes 103–05 and accompanying text (discussing how the courts' decisions in *Esopus* and *Dart* transgressed the business judgment rule). One can also question whether courts found *Schnell* violations based on the

major departure from the business judgment rule, all *Schnell* cases except *Esopus* and *Dart* ended up in the right place: in all of the other cases, the courts' explicit or implicit findings that the directors breached their fiduciary duties[102] would have prevented these directors from enjoying the protection of the business judgment rule. Therefore, even if those courts had followed the business judgment rule, they ultimately would have been able to evaluate the directors' decision.

Esopus turns this paradigm on its head. After finding that the directors did not have any entrenchment motive or bad faith, the court nevertheless proceeded to evaluate the directors' conduct anyway, decided that conduct was unfair, and then equated unfair conduct with a *Schnell* violation.[103] The court in *Esopus* should not have been able to second guess the fairness of the board's decision unless it first found fault in the process. In other words, although the court found no fault in the process that the directors employed in making their decision, Vice Chancellor Lamb simply invalidated the directors' conduct because he did not like it. Tellingly, in *Dart*, the court explicitly rejected any allegation that could relate to a breach of fiduciary duty.[104] Despite that determination, Vice Chancellor Maurice Hartnett proceeded to evaluate the directors' conduct and concluded it could be unfair. Former Delaware Supreme Court Chief Justice Myron Steele, in an unrelated case, dissented on the same grounds that *Esopus* and *Dart* are faulty; among other reasons, the court found the directors' conduct inequitable without finding they had violated their fiduciary duties.[105]

Thus, the fourteen *Schnell* cases are instructive in two ways. First, all conduct that violates the *Schnell* doctrine is, or should also be, a breach of fiduciary duty, and the failure of *Schnell* and other cases applying the *Schnell* doctrine to state so clearly does not negate this truism. As the court in *Rabkin v. Philip A. Hunt Chemical Corp.* aptly described, these cases are a "breach of fiduciary duties under *Schnell*."[106] Second, if a judge applies

entrenchment effect of the directors' actions despite also finding that these respective directors had no improper motive. *See generally Linton*, No. 15219, 1997 WL 441189; *Hubbard*, No. 11779, 1991 WL 3151; *Lerman*, 421 A.2d 906.

102. *See supra* notes 52–54, 59–78, and accompanying text.

103. *See supra* notes 82–85 and accompanying text.

104. *See supra* note 87 and accompanying text.

105. *See* Omnicare Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 946–50 (Steele, J., dissenting) (disagreeing with the majority's invalidation of a contract when "the board of directors acted selflessly pursuant to a careful, fair process and [acted] in good faith . . . .").

106. Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1105 (Del. 1985); *see also supra* notes 52-54 and accompanying text (delineating *Schnell* cases that held, or strongly intimated, that there was a breach of fiduciary duties).

the *Schnell* doctrine to a case where the directors did not breach their fiduciary duties, the judge has invalidated legal conduct based simply on his or her gut instinct. The implications of judges deciding cases based solely on their instincts are profound.

Just as judges ought to find a breach of fiduciary duty if they find a *Schnell* violation, so too have scholars equated *Schnell* violations with a breach of fiduciary duties. For example, Chief Justice Strine—as Vice Chancellor—wrote an article analyzing a different aspect of the *Schnell* doctrine from the one explored here.[107] In his article, Chief Justice Strine often interchanged the concepts of *Schnell* violations and breaches of fiduciary duties.[108] Similarly, Professor Larry Ribstein used *Schnell* as one of two cases to support the principle that "fiduciary duties . . . trump statutory authorization."[109] Finally, in a group-authored article about the duty of loyalty, the authors wrote, "[i]n *Schnell*, the Delaware Supreme Court emphatically voiced its acceptance of the importance of fiduciary review in ensuring that the capacious authority granted to directors by the DGCL was not misused."[110]

A. The Current Bylaw Cases — More Confusion about the Schnell *Doctrine and Breaches of Fiduciary Duties*

There are several Delaware cases where judges have declared a given bylaw to be facially valid, while also holding that shareholders can again challenge the situational validity of the bylaw if their corporation ever implements it.[111] For example, in *Moran v. Household Internationa'l*,

107. *See* Strine, *supra* note 1, at 880 (discussing the role of law and equity in Delaware-corporate law and the need for judges to "respect the law side of the law-equity divide in exercising their equitable powers," such as when judges are engaged in a *Schnell* review).

108. *See, e.g.*, *id.* at 880 (discussing *Schnell* violations in the context of breaches of fiduciary duties); *id.* at 881 (noting that *Schnell* reinforced the role of equity and defined equity as "the judge-made common law of corporations as reflected in judicial articulations of the fiduciary duties of directors and officers"); *id.* at 882 (stating that *Schnell* reinforced "[t]hat equitable principles of fiduciary duty would be an overlay to and a constraint on the statutory powers of directors"); *id.* at 887 (identifying the key disputes in *Schnell* cases and noting that they "were about whether legally permissible actions were . . . equitable in the sense that they were not tainted by a breach of fiduciary duty"); *id.* at 903 (finding that *Schnell* "permits the invalidation of legally permitted acts that result from a breach of an equitable duty"); *see also* supra note 21 and accompanying text.

109. Larry E. Ribstein, *Preemption as Micromanagement*, 65 BUS. LAW. 789, 795 (2010).

110. Strine et al., *supra* note 21, at 642.

111. *See generally* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 555 (Del. 2014); Stroud v. Grace, 606 A.2d 75 (Del. 1992); Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229 (Del. Ch. 2014); Edgen

Inc.,[112] the Delaware Supreme Court upheld a director-enacted poison-pill bylaw[113] but cautioned that the court would review the bylaw again under fiduciary standards if its implementation is challenged:

> When the Household Board of Directors is faced with a tender offer and a request to redeem the Rights, they will not be able to arbitrarily reject the offer. They will be held to the same fiduciary standards any other board of directors would be held to in deciding to adopt a defensive mechanism, the same standard as they were held to in originally approving the Rights Plan.[114]

Note that the Delaware Supreme Court reasoned that implementation would be subject to fiduciary review,[115] but the court made no mention of the *Schnell* doctrine.

Before the Delaware legislature's recent amendments to the DGCL to outlaw fee-shifting in stock corporations and to permit forum-selection clauses,[116] Delaware courts again used *Moran*'s two-step model to rule on the facial validity of director-enacted bylaws on these two subjects. Unlike the court in *Moran*, the Delaware courts mentioned *Schnell* in both of the recent cases. In an *en banc* opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court responded to four certified questions of law regarding the validity of a director-adopted bylaw in a non-stock corporation that shifted attorneys' fees and costs to unsuccessful plaintiffs in intra-corporate litigation.[117] Although declaring such a bylaw to be facially valid,[118] Justice Carolyn Berger warned, without mentioning fiduciary duties—but still citing to *Schnell*—that "[b]ylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose."[119] Following *Moran*, Justice Berger further held that the future enforceability of any fee-shifting bylaw would depend on the

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Grp. Inc. v. Genoud, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013); Boilermakers Local 154 Ret. Fund v. Chevron, 73 A.3d 934 (Del. Ch. 2013).

112. 500 A.2d 1346 (Del. 1985).

113. *Id.* at 1357; *see also* MELVIN ARON EISENBERG & JAMES D. COX, BUSINESS ORGANIZATIONS CASES AND MATERIALS 1239 (11th ed. 2014) (defining a poison-pill bylaw as "a plan under which the board of directors of a corporation creates Rights that are distributed or distributable to shareholders . . . [and] upon the occurrence of certain events shareholders . . . have the right to purchase stock in the corporation . . . at a deep discount. Because the potential exercise of the Rights would dramatically dilute the value of the target stock that the bidder proposes to acquire, the mere potential that the Rights will be exercised may serve as a deterrent to making a bid in the first place.").

114. *Moran*, 500 A.2d at 1354.

115. *Id.*

116. DEL. CODE ANN. tit. 8 §§ 102(f), 109(b), 114(b)(2), 115 (West 2015).

117. 91 A.3d 555 (Del. 2014).

118. *Id.* at 560.

119. *Id.* at 558.

facts under which the directors actually implement the bylaw.[120]

Similarly, in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, then-Chancellor Strine held that board-adopted forum-selection bylaws were facially valid.[121] The court further held that "valid bylaw[s] may operate inequitably in a particular scenario" and would be dealt with by the *Schnell* doctrine.[122] The court warned that, if and when the directors implement the bylaw, "a court will have a concrete factual situation against which to . . . analyze, *à la Schnell,* whether the directors' use of the bylaws is a breach of fiduciary duty."[123]

Thus, in discussing the standard for monitoring director bylaws when they are actually implemented, the Delaware Supreme Court in *Moran* discussed only fiduciary duties and in *ATP* discussed only *Schnell*; however, the Delaware Court of Chancery in *Boilermakers* discussed both fiduciary duties and *Schnell* interchangeably. *ATP,* a 2014 *en banc* Delaware Supreme Court opinion, demonstrated that Delaware courts have not yet incorporated the interplay between *Schnell* violations and breaches of fiduciary duties.[124]

III. WHY HAVE TWO DOCTRINES?

In an intriguing article,[125] former-Justice Jack Jacobs asked a perceptive question about the logic of the Delaware Supreme Court's opinion in *Alabama By-Products Corp. v. Neal*, a case which admonished courts to

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120. *Id.* at 558–60.

121. 73 A.3d 934 (Del. Ch. 2013).

122. *Id.* at 949.

123. *Id.* at 959; *see also id.* at 954 (remarking, "the real-world application of a forum selection bylaw can be challenged as an inequitable breach of fiduciary duty" and citing to *Schnell*); *id.* at 958 (reasoning that the plaintiff may mount an argument under *Schnell* that the bylaw "should not be enforced because the bylaw was being used for improper purposes inconsistent with the directors' fiduciary duties").

124. Unlike the *Schnell* doctrine, all Delaware equitable remedies need not monitor only fiduciary duties. For example, the equitable remedy of quasi-appraisal rights can monitor breaches of the fiduciary duty of disclosure as well as non-fiduciary breaches. *Compare* Gilliland v. Motorola, Inc., 873 A.2d 305, 308 (Del. Ch. 2005) (reasoning the directors "breached their fiduciary duty of disclosure by not providing any disclosure relating to [the corporation's] financial condition to the stockholders faced with the decision of whether to take the cash or demand appraisal"), *with* Nebel v. Southwest Bancorp, Inc., 1995 Del. Ch. LEXIS 80 (Del. Ch. July 5, 1995) (reasoning that although the directors failed to provide shareholders with an accurate copy of the appraisal statute in connection with a short-form merger, directors did not breach their fiduciary duties). *See also* Mary Siegel, *The Dangers of Equitable Remedies*, 15 STAN. J.L. BUS. & FIN 86, 110 (2009) (stating that, in quasi-appraisal cases, "the primary fact pattern is that defendant allegedly violated its fiduciary duty to disclose, and that violation impacted plaintiffs' process of deciding whether to take the merger consideration or demand appraisal rights").

125. Jacobs, *supra* note 18.

limit the *Schnell* doctrine to cases that either "threaten the fabric of law" or would "deprive a person of a clear right."[126] Specifically, Justice Jacobs wrote:

> How does one decide whether fiduciary conduct 'threatens the fabric of the law?' And if equity can be used to override the law only where an 'improper manipulation of the law would deprive a person of a clear right,' why is equity needed at all, since if the right being violated is clear, that alone would afford a basis for relief.[127]

In other words, Justice Jacobs pointed out that, under the Delaware Supreme Court's standards delineated in *Alabama By-Products*, the *Schnell* doctrine would serve no purpose; the standard is both too amorphous to decide what is threatening to the fabric of law, and it is superfluous if a clear right exists. Similarly, this Article asks the same question about the need for the *Schnell* doctrine, but this time, the question is based on *Schnell's* redundancy: why is the *Schnell* doctrine needed when Delaware courts incontrovertibly have the power to invalidate otherwise legal conduct based on a breach of fiduciary duties? Phrased differently, having established that all *Schnell* violations are, or should be, breaches of fiduciary duty, what are the costs and benefits of maintaining the *Schnell* doctrine, and what would be the costs and benefits from abolishing it?

A. Are There Benefits and Costs of Maintaining the Status Quo?

Four possible arguments exist for retaining the *Schnell* doctrine as a tool for judicial review. The first is that the *Schnell* doctrine is still needed to require fiduciaries to comply with both legal and equitable duties. A second argument is that the *Schnell* doctrine is case-specific while some case holdings delineating fiduciary duties have broader applicability. Third, if the *Schnell* doctrine remained available, it could serve as the reservoir for analyzing all voting cases instead of maintaining the current patchwork of voting monitors.[128] The final argument is that the *Schnell* doctrine permits the court to have a broader reach: a judge could use the doctrine to invalidate conduct that simply does not "feel" right even when the judge cannot find a breach of fiduciary duty. All four of these arguments, however, lack merit.

First, while *Schnell* may have been necessary—or at least instrumental—in establishing the role of equity in Delaware corporate law,[129] the *Schnell* doctrine is no longer needed for this purpose. No one would seriously

126. 588 A.2d 255, 258 n.1 (Del. 1991).

127. Jacobs, *supra* note 18, at 11.

128. *See infra* note 139 and accompanying text.

129. *See supra* notes 17–21 and accompanying text (discussing the role of *Schnell* after the passage of the DGCL in 1967).

challenge that directors must comply not only with the DGCL and the corporation's own legal documents but also with the directors' fiduciary duties. As Chancellor Allen reasoned in *Stahl v. Apple Bancorp, Inc.*, "[i]t is an elementary proposition of corporation law that . . . fiduciary duties constitute a network of responsibilities that overlay the exercise of even undoubted legal power."[130] One may further ask how instrumental the *Schnell* doctrine continues to be since its initial foundational contribution to Delaware corporate law if there have only been fourteen violations in the doctrine's forty-five year history.[131]

Second, some may argue that fiduciary duties and *Schnell* violations differ in that Delaware courts apply the *Schnell* doctrine in discrete situations, affecting the rights of one corporation's shareholders. In contrast, in at least some cases where courts have held that directors breached their fiduciary duties, the court's articulation of those duties has had broad applicability, extending beyond the particular case. *Weinberger*, for example, delineated requirements for directors to satisfy their fiduciary duties in a conflict-of-interest going private transaction.[132] *Unocal Corp. v. Mesa Petroleum Co.*, as modified by *Unitrin, Inc. v. American General Corp.*, similarly gave content to directors' fiduciary duties in the context of their enacting defensive tactics,[133] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* did so for so-called "*Revlon*" transactions.[134] As now Chief Justice Strine wrote, "[b]ecause of the importance of fiduciary duty review to our system of corporate law, the judiciary will often issue decisions that have more than case-specific influence."[135] Whether decisions finding fiduciary breaches have narrow or broad applicability does not detract, however, from the fundamental fact that since *Schnell* review constitutes fiduciary review, the existence of two doctrines is redundant.

Third, an argument can be made that the *Schnell* doctrine should be the

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130. 579 A.2d 1115, 1121 (Del. Ch. 1990).

131. *See supra* note 51 (delineating the fourteen cases where courts have found *Schnell* violations).

132. *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (requiring fair dealing and fair price in a conflict-of-interest going-private transaction); *see also supra* notes 22–28 and accompanying text.

133. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985), and Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (requiring directors who enact defensive tactics to demonstrate a threat to the corporation's policies, and to have reacted reasonably, including but not limited to not enacting coercive or preclusive defensive tactics).

134. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985) (requiring directors to attempt to maximize profits for shareholders when the corporation is in so-called *Revlon* mode).

135. Strine, *supra* note 1, at 904–05.

go-to monitor for shareholder voting, the most likely candidate for a topic that "threatens the fabric of corporate law."[136] Two problems exist with this argument. One is that, although most *Schnell* cases are about shareholder voting,[137] the *Schnell* doctrine has no topical limits.[138] Second, even if the Delaware Supreme Court cabined the *Schnell* doctrine to cases about shareholder voting, that decision alone would not effectuate a consolidation of all voting cases, given that Delaware courts have reviewed cases about shareholder voting under myriad monitors.[139] Furthermore, to date, Delaware courts have given no indication either that all voting issues should be corralled into one monitor or, if so, that the monitor of choice would be the *Schnell* doctrine.[140]

The final argument supporting retention of the *Schnell* doctrine—and perhaps the only contentious one—is that the *Schnell* doctrine permits judges to invalidate action that simply does not "feel" right without the conduct constituting a breach of fiduciary duty. The argument is that the doctrine empowers judges to utilize their equitable powers to effectuate the result they instinctively believe is correct by labeling the conduct as inequitable as the courts did in *Esopus* and *Dart.*[141] Invalidating legal action that simply does not "feel" right to a judge, however, is a standard

136. Alabama By-Products v. Neal, 588 A.2d 255, 259 n.1 (Del. 1991); *see also supra* text accompanying note 126.

137. *See supra* note 50 (noting that six of the fourteen *Schnell* cases are about shareholder voting for directors and that another four cases involve shareholder voting on transactions).

138. *See, e.g.*, Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1106–07 (Del. 1985) (applying *Schnell* when defendants attempted to evade the corporation's contractual commitment to cash-out the minority shareholders at a fixed price); Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (applying *Schnell* when defendants froze out minority shareholders without a valid corporate purpose); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1081 (Del. Ch. 2004) (applying *Schnell* when the CEO and controlling shareholder enacted a bylaw to disable the board from performing its statutorily-authorized duties); Hamilton v. Nozko, No. 13014, 1994 WL 413299, at *6–7 (Del. Ch. July 27, 1994) (applying *Schnell* when the defendants intentionally delisted the corporation to force the minority to sell their shares at a grossly unfair price).

139. Delaware courts have reviewed some voting cases under the business judgment rule, *see* City of Westland Police & Fire Ret. Sys. v. Axcelis Tech., Inc., 1 A.3d 281, 291 (Del. 2010), under enhanced business judgment, *see* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985), and under the compelling purpose test, *see* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661–02 (Del Ch. 1988); *see also* discussion of *Blasius supra* notes 34–37 and accompanying text (discussing voting monitor).

140. *Cf.* Mercier v. Inter-Tel, Inc., 929 A.2d 786, 810 (Del. Ch. 2007) (suggesting that the enhanced business judgment monitor would be preferable to the compelling-purpose test as a monitor of voting issues).

141. *See* discussion of *Esopus* and *Dart, supra* notes 90–95 and accompanying text.

most jurists would eschew.[142] Why permit courts to invalidate directors' otherwise legal conduct based on feel instead of by an articulation of why the conduct constitutes a breach of fiduciary duty? Moreover, as demonstrated above,[143] since nearly all *Schnell* cases are breaches of fiduciary duties, neither *Schnell* nor its progeny seem to authorize judges to invalidate legal conduct based simply on an uneasy feeling. Perhaps this lack of authority is the answer as to why there are only fourteen cases decided under *Schnell*: Delaware judges instinctively know that they should articulate why they choose to invalidate conduct that is legally sufficient and that invalidation inevitably becomes a discussion of a breach of fiduciary duty rather than about the judge's gut instinct. One of Chief Justice Strine's earlier articles forcefully echoed this concern about *Schnell* violations:

> [A] determination that legally permitted action should be enjoined *requires the court to find that there was a specific breach of an equitable duty*. That does not necessarily mean that the judge must conclude that the directors acted for a disloyal purpose. But, at minimum, *it requires the court to articulate why the directors did not fulfill their fiduciary duties in the circumstances they confronted*. . . The very requirement to explain how actual businesspersons violated the equitable standard of conduct required of them tempers judicial overreaching and encourages modesty.[144]

In other words, articulating the contours and causes of the fiduciary breach has the concomitant effect of preventing judges from invalidating action that simply does not feel right and "tempers judicial overreaching."[145] It is thus not surprising that Justice Strine articulated the breach of fiduciary duty in all opinions in which he applied the *Schnell* doctrine.[146] If judges are indeed utilizing some gut feeling instead of a

142. *See, e.g.*, Nixon v. Blackwell, 626 A.2d 1366, 1378 (Del. 1993) ("The court's decision should not be the product solely of subjective, reflexive impressions based primarily on suspicion or what has sometimes been called the 'smell test.'""); KE Prop. Mgmt., Inc. v. 275 Madison Mgmt. Corp., Civ. A. No. 12683, 1993 WL 285900, at *9 (Del. Ch. July 27, 1993) (citing *Nixon* for the same proposition); *see also infra* notes 144–45 and accompanying text (noting Chief Justice Strine's statement that a judge must "articulate why the directors did not fulfill their fiduciary duties" to "temper[] judicial overreaching").

143. *See supra* notes 52–54, 59–78, and accompanying text (explaining twelve of fourteen *Schnell* cases are also fiduciary breaches).

144. *See* Strine, *supra* note 1, at 904 (emphasis added); *see also id.* at 888 ("Importantly, even when a court was deploying the tightened reasonableness standard, its ability to strike down lawful action required it to identify expressly why the directors had acted unreasonably in the circumstances and therefore breached their fiduciary duties.").

145. Strine, *supra* note 1, at 904.

146. *See* Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 75 (Del. Ch. 2008) (finding the CEO breached fiduciary duties and violated the *Schnell* doctrine by intentionally

reasoned fiduciary analysis, they are making bad law.

There is no current benefit to retaining the *Schnell* doctrine, but there is a cost to maintaining the status quo: the coexistence of the *Schnell* doctrine and fiduciary law implies that there is a difference between the two forms of review. Twelve of the fourteen *Schnell* cases counter that inference, and the remaining two cases, *Esopus* and *Dart*, demonstrate the dangers where *Schnell* violations are not fiduciary breaches. Thus, the current coexistence of the *Schnell* doctrine and fiduciary review is confusing if all *Schnell* violations are—or should be—a breach of the duty of loyalty and of great concern if they are not.

B. Would There Be Benefits or Costs to Abolishing the Schnell *Doctrine?*

The major benefit of abolishing the *Schnell* doctrine would be judicial recognition that directors' legal actions can be invalidated only if the directors breached their fiduciary duties. A clear process that adheres to the tenets of the business judgment rule and that is thoroughly articulated would enhance the clarity and consistency that is a hallmark of Delaware law.[147] An ancillary benefit is abolition of the doctrine obviates any need to resolve the different judicial views on whether *Schnell* violations require directors to have acted with an improper motive.[148] Since identifying the directors' "true" motive can be a daunting task,[149] abolishing the *Schnell*

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using corporate assets to coerce shareholders into voting as the CEO wanted); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1081 (Del. Ch. 2004) (finding that conduct of the CEO and controlling shareholder was a breach of fiduciary duty and a violation of *Schnell* because the shareholder-enacted bylaw amendments' sole purpose was to prevent the board from performing its statutorily-authorized duties and to effectuate illegal or inequitable activities); *cf.* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 949 (Del. Ch. 2013) (reasoning by then-Vice Chancellor Strine that the directors' implementation of their bylaw could, in the future, violate *Schnell* if the directors breached their fiduciary duties).

147. *See, e.g.*, *The Hon. Myron T. Steele: Delaware Courts, Corporate Governance And Corporate Counsel*, METRO. CORP. COUNSEL, Nov. 1, 2004, at 52, http://www.metrocorpcounsel.com/articles/4765/delaware-hon-myron-t-steele-delaware-courts-corporate-governance-and-corporate-counsel ("We must be sure that our opinions continue to be characterized by three words that are the hallmark of Delaware courts: predictability, consistency and clarity.").

148. *See supra* notes 92–93 (noting inconsistent holdings on whether *Schnell* violations require an improper motive).

149. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721–22 (Del. 1971) (reasoning that, if shareholders got their *pro rata* share of the benefits of each of the three challenged transactions, the court would conclude that the directors had not been motivated by self-interest); Mary Siegel, *The Problems and Promise of "Enhanced Business Judgment",*" 17 U PA. J. OF BUS. L. 47, 73–74 (2014) (identifying that Delaware courts have looked for tangible harm to the corporation to determine whether directors were truly motivated to act in the best interest of the corporation or whether they instead had a selfish motive either when they enacted defensive tactics or when the corporation was in a "*Revlon*" mode).

doctrine would help courts considerably.

If one accepts the premise that *Schnell* violations are simply a subset of breaches of the duty of loyalty, there is no cost to abolishing the *Schnell* doctrine. Abolition of the *Schnell* doctrine should not cause shareholders any concern that such abolition empowers directors to implement any bylaw under any circumstance, manipulate the voting process, or take any other inequitable action that constitutes a breach of fiduciary duty. Similarly, courts should not fear that abolition of the *Schnell* doctrine dilutes their equitable powers.

CONCLUSION

At its inception, the *Schnell* doctrine undoubtedly served the important function of establishing the role of equity in Delaware corporate law. A clear-eyed view of the doctrine, however, demonstrates that *Schnell* violations are nothing more than breaches of fiduciary duty and should be nothing less. Importantly, if the *Schnell* violation is less than a breach of fiduciary duty, then the doctrine wrongly empowers judges to invalidate otherwise legal conduct based only on intuitive unease with directors' or controlling shareholders' conduct.

All arguments for keeping a doctrine that allows the courts to effectuate their perception of a fair result may appear reasonable, but the dangers of such an approach have been well-documented. In fact, the *Schnell* doctrine has become a wolf in sheep's clothing by transgressing the business judgment rule. Given the unassailable benefits of the business judgment rule, applying the *Schnell* doctrine in violation of the rule has broad negative implications for Delaware corporate law.